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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 21, 2001

APPLICATION OF

VIRGINIA GAS PIPELINE COMPANY

CASE NO. PUE010310

For an Annual Informational Filing

ORDER ADOPTING RECOMMENDATIONS
AND DISMISSING PROCEEDING

On May 25, 2001, Virginia Gas Pipeline Company ("VGPC" or "the Company") filed its application for an Annual Informational Filing ("AIF") with the State Corporation Commission ("Commission"). This application included financial and operating data for the twelve months ended December 31, 2000.

On November 30, 2001, the Commission Staff filed its report on the captioned application, which included a financial and accounting analysis. Staff noted in its report that it used a 13.5% return on equity for illustrative purposes only. It explained that in VGPC's application for certificates of public convenience and necessity for the Company's storage and pipeline facilities, the Company assumed a cost of equity of 13.5%. The Staff used the consolidated capital structures of Virginia Gas Company ("VGC"), VGPC's former parent, in its financial analysis for this AIF because VGC is the primary entity that raised

capital on behalf of VGPC for the test period. This consolidated capital structure, together with a 13.50% cost of equity, produced an overall weighted cost of capital of 10.627%.

Staff noted that NUI Corp ("NUI"), an exempt natural gas holding company, consummated the acquisition of VGC and VGC's ownership and control of VGPC's sister companies on March 28, 2001. Staff reported that it did not consider NUI's consolidated capital structure for purposes of its report because NUI's acquisition of VGC and VGPC was not authorized or executed during the test year. Staff advised that it intended to re-evaluate the appropriate ratemaking capital structure for VGPC in the Company's next AIF or rate proceeding. Staff stated that if VGPC's maturing operations push its adjusted return on equity closer to 13.5%, Staff may request the Commission to initiate a proceeding to investigate an appropriate return on equity specific for the Company.

In its accounting analysis, the Staff noted that it had reached an agreement that had been accepted by the Commission in Case No. PUE980627, regarding the treatment of capitalized interest. Based on Staff's analysis of the Company's earnings for the test year, the Company had not recovered its interest costs. Staff adjusted VGPC's cost of service to remove \$558,095 of cumulative jurisdictional capitalized interest from the Company's rate base.

Staff has advised the Company that the agreed upon treatment regarding capitalized interest is an exception to the Commission's long standing approach regarding capitalized interest. Staff acknowledged that there may come a time when it may no longer be appropriate to capitalize VGPC's interest. Staff observed that inclusion of capitalized interest in VGPC's rate base should continue to be scrutinized in VGPC's next AIF or rate case, and that the Company should reflect capitalized interest at a level consistent with the use of the agreed upon methodology in its future filings.

With regard to the treatment of costs associated with Segment 5 of VGPC's pipeline project, Staff reported that VGPC's certificate of public convenience and necessity to construct the Radford to Roanoke leg of its P-25 pipeline has been revoked. In view of these circumstances, Staff recommended that the costs associated with Segment 5 should be reclassified to Account 182.3, Other Regulatory Assets, and Account 107, Construction Work in Progress, should be credited. Further, the Staff recommended that VGPC should capitalize property taxes on amounts relating to property under construction.

Staff stated that the Company's 3.28% adjusted return on equity fell below any return on equity recently authorized by the Commission as well as the 13.50% cost rates used in the

Staff Report. Based upon these measures, Staff did not propose any action concerning the Company's rates.

Finally, the Staff noted that the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings adopted in Case No. PUA990054 specify that AIFs be filed within 120 days after the end of a test period. Staff reminded VGPC that should it require a waiver from filing its AIF within 120 days after the end of its test period, it should do so before the end of the 120 day period.

By letter dated December 14, 2001, the Company, by counsel, advised that it did not intend to file comments in response to the Staff Report.

NOW, UPON consideration of the Company's application, the Staff's Report, and the applicable statutes, the Commission finds that the Staff's recommendations found in Staff's November 30, 2001 Report are reasonable and should be adopted. We note that the inclusion of capitalized interest in rate base for the test year ending 2000, is subject to our continuing evaluation of the propriety of this ratemaking treatment, monitoring the Company's growth rate, construction activity, plans for future expansion, earnings trends, and financial condition.

We further find that for ratemaking purposes, VGPC should present its capitalized interest in a manner consistent with the

agreement regarding capitalized interest accepted in Application of Virginia Gas Pipeline Company, For an Annual Informational Filing, Case No. PUE980627, 1999 S.C.C. Ann. Rept. 443. In the event VGPC books its capitalized interest in a manner that differs from that accepted herein for ratemaking purposes, the Company shall maintain sufficient records to track the resulting differences in plant in service, Construction Work In Progress, accumulated depreciation, and accumulated deferred income taxes.

Finally, we adopt Staff's recommendations regarding the treatment and booking of the costs associated with Segment 5 of VGPC's pipeline project as well as its recommendations regarding the capitalization of property taxes relating to property under construction.

Accordingly, IT IS ORDERED THAT:

(1) Consistent with the findings made herein, the booking, accounting and other recommendations set out in the Staff's November 30, 2001, Report are hereby adopted. VGPC shall incorporate these recommendations in its next AIF or rate application.

(2) There being nothing further to be done herein, this matter shall be dismissed from the Commission's docket of active proceedings, and the papers filed herein placed in the Commission's file for ended causes.